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SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1929.

No. 226

THOMAS A. EARLY, RECEIVER OF THE FARMERS & MERCHANTS NATIONAL BANK OF LAKE CITY, PETITIONER,

v.

FEDERAL RESERVE BANK OF RICHMOND, RESPONDENT.

BRIEF OF PETITIONER.

R. E. WHITING,
Counsel for Petitioner.

F. G. AWALT,
GEORGE P. BARSE,
Attorneys for Comptroller of Currency,
Of Counsel.

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SUPREME COURT OF THE UNITED STATES.

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No. 226

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v.

FEDERAL RESERVE BANK OF RICHMOND, Respondent.

BRIEF OF PETITIONER.

I.

The Opinions of the Courts Below.

The order of judgment made by the District Judge (R. p. 11) is not officially reported.

The opinion of the Circuit Court of Appeals, Fourth Circuit (R. p. 68) is officially reported in 30 Fed. (2) 198.

II.

Jurisdiction.

Writ of certiorari was granted October 21, 1929.

III.

Statement of the Case.

A. *The Proceedings Below and the Issue.*

Suit was filed, at law, in the District Court of the United States for the Eastern District of South Carolina by the Receiver of the Farmers and Merchants National Bank of Lake City, South Carolina (hereinafter referred to as the Lake City Bank), against the Federal Reserve Bank of Richmond (hereinafter referred to as the Reserve Bank), on two causes of action: (1) to recover a reserve deposit balance of $22,088.48 alleged to have been owing by the Reserve Bank to the Lake City Bank at the time of the failure and suspension of the latter; (2) to recover the sum of $4,115.15, constituting the surrender value, with accrued dividends, of 78 shares of stock in the Reserve Bank owned by the Lake City Bank at the time of its failure (R. pgs. 1-4). The Reserve Bank admitted the amount of the deposit balance and of the surrender value of the stock, but claimed the right to apply the same toward the payment of certain checks drawn on the Lake City Bank which the Reserve Bank had received for collection from its customer banks and under its rules had

forwarded to the Lake City Bank for payment, the checks having been thereafter received by the Lake City Bank and canceled, but failure and suspension of the Lake City Bank having intervened before remittance or payment to the Reserve Bank had been made by the Lake City Bank for said checks. The aggregate amount of said deposit balance and of said surrender value of said stock was substantially less than the amount of the checks so forwarded by the Reserve Bank to the Lake City Bank, and the Reserve Bank, in addition to asserting the right to apply said deposit and said surrender value of said stock toward payment for said checks, also filed counter-claim against the Receiver for the deficiency (R. pgs. 4-9).

Jury was waived and the case was tried upon a stipulation of facts (R. pgs. 10-11; 15-23), certain letters and documents also being introduced in addition to the agreed statement of facts (R. pgs. 23-35).

Judgment was entered in favor of the Receiver for recovery of the deposit, and for the surrender value of the stock, with interest (R. pgs. 11-14), and the Reserve Bank appealed to the Circuit Court of Appeals.

The Circuit Court of Appeals reversed the Trial Court on the first cause of action, relating to the deposit balance, holding, in substance, that under the collection contract an equitable charge or lien existed against the deposit balance in favor of the owners of the checks forwarded to the Reserve Bank for collection and that consequently the Reserve Bank properly applied the deposit balance toward satisfaction of such equitable charge or lien (R. pgs. 68-76).

Judgment was affirmed on the second cause of action relating to the surrender value of the stock, the Circuit Court of Appeals holding, in substance, that inasmuch as the Reserve Bank had received the checks in question as agent for collection, *the amounts due for said checks were owing, not to the Reserve Bank, but to the customers of the Reserve Bank, and that consequently there was no mutuality permitting a set-off*, and the Reserve Bank could not, as agent for collection, set off the amount owing under said checks against the amount which it owed to the Receiver of the Lake City Bank for the surrender value of said stock (R. pgs. 76-77).

The reversal of the Trial Court on the first cause of action, relating to the deposit account, although awarding a new trial, was final in substance and conclusive upon the Trial Court in respect to the judgment to be entered in the cause, and it was for the purpose of obtaining a review of this portion of the Circuit Court of Appeals' decision that the application for writ of certiorari was made.

The Issue.

It is the contention of the Receiver that the collection contract did not raise an equitable lien or charge against the reserve deposit of the failed bank, and that suspension of the bank fixed the status of its reserve deposit as part of its general assets, and that no charges could thereafter be made by the Reserve Bank to deplete such deposit account for the purpose of giv-

ing the customers and depositors of the Reserve Bank a preferred status at the expense of the general creditors of the Lake City Bank.

B. *The Facts Concerning the Collection Contract.*

The Reserve Bank had received the checks in question from its customers as a collection agent, and had transmitted the same to the Lake City Bank (R. pgs. 15, 17, 18) under the clearing and collection system which the Reserve bank had established by virtue of its authority to act as a clearing house for its member banks, as permitted by Section 16 of the Federal Reserve Act (12 U. S. C. A. 248 (*m*)), and Regulation J, Series of 1924, promulgated by the Federal Reserve Board (R. p. 43). The details of its collection system were set forth in a letter of instructions to member banks known as "Circular No. 143," issued by the Reserve Bank under authority of said Regulation J, Series of 1924 (R. p. 47). For convenience of reference, the pertinent statutory provisions, and Regulation J, Series of 1924, are, respectively, set out in full in Appendices A and B of this brief. Section VI of said Regulation J authorizes the issuance by a Reserve bank of such collection circulars for the purpose of "governing the details of its check clearing and collection operations", and provides that said circulars or letters of instruction

> "Shall be binding upon any member or non-member clearing bank which sends any check to such Federal Reserve Bank for collection * * *" (R. P. 47).

The Circuit Court of Appeals summarized certain features of this collection system in the following language:

> "This collection system, which was agreed to by the forwarding banks as well as by the banks upon which the checks were drawn, was characterized, so far as the checks here are concerned, by the following provisions: (1) The Reserve Bank was acting only as agent of the forwarding banks and assumed no liability except for its own negligence; (2) it was authorized to send the checks direct to the drawee bank for collection; (3) the amount of any check for which payment 'in actually and finally collected funds' was not received by the Reserve Bank was authorized to be charged back to the forwarding bank, regardless of whether or not the check itself could be returned; and (4) the checks, unless promptly returned by the drawee bank, were to be charged to its account with the Reserve Bank at the expiration of a designated transit time, in this case three days, but the latter bank reserved the right to so charge them at any time when in any particular case it was deemed necessary to do so * * *" (R. p. 69).

In addition it may be noted that Section IV of Regulation J requires each Reserve Bank to publish a schedule showing the time at which any item sent to it will be counted as reserve and become available for withdrawal or other use by the sending bank (R. p. 45) and that the time schedule fixed by the Federal Reserve Bank of Richmond for checks drawn on South Carolina was three days (R. pgs. 57-58). *Checks received*

by a Reserve Bank for collection are transmitted to its member drawee bank in a letter generally designated as a "cash letter." In the instant case the Reserve Bank forwarded on October 7, 1926 to the Lake City Bank, a *cash letter* containing checks drawn against the latter amounting to $14,900.62 (less checks dishonored and returned). On October 8, 1926 the Reserve Bank forwarded a cash letter containing checks drawn upon the Lake City Bank amounting to $20,-170.71 (less checks dishonored and returned). The Lake City Bank received the first cash letter on October 8th and the second on October 9th, and immediately acknowledged receipt of them to the Reserve Bank, the accepted checks being charged by the Lake City Bank to the accounts of the various drawers and marked "paid" (R. pgs. 17-18), and the aggregate amount of the checks in each cash letter being credited to a memorandum account pending the expiration of the three day transit period, the practice being to credit the amounts of such checks to the Reserve Bank at the *expiration of the transit time* (R. pg. 16), *assuming, of course, that the Lake City Bank had not, during the transit period, forwarded payment for said checks in cash or by draft or in some other manner.* In this connection, the pertinent portion of said Circular No. 143 is as follows:

> "Checks received by us drawn on our member banks will be forwarded in cash letters direct to such banks and each member bank *will be required either to remit therefor in immediately available funds or to provide funds available to us to meet such cash letters within the agreed*

> *transit time* to and from the member bank. Therefore, the amount of any cash letter to a member bank is chargeable against *available funds* in the reserve account of such member at the *expiration of such transit time*, which date will be shown on each cash letter. The right is reserved, however, to charge a cash letter to the reserve account of a member bank at any time when in any particular case we deem it necessary to do so." (Italics inserted.) (R. 55.)

The cash letter of October 7, 1926 shows the following notation:

> "Dispatched October 7, 1926. Chargeable against *available* balance in reserve account October 11, 1926." (Italics inserted.) (R. p. 62.)

The cash letter of October 8, 1926 shows the following notation:

> "Dispatched October 8, 1926. Chargeable against *available* balance in reserve account October 12, 1926." (Italics inserted.) (R. p. 63.)

No additional funds were obtained by the Lake City Bank in the collection of these checks, collection being accomplished by bookkeeping entries charging the checks to the accounts of the respective drawer-depositors of the bank. By accepting such checks from the Reserve Bank under Circular No. 143, the Lake City Bank impliedly agreed, as to the checks in said two cash letters, that it would make payment for the same at Richmond at the expiration of the three day transit period.

IV.

Specification of Errors.

The Circuit Court of Appeals erred in holding that the acceptance by the Lake City Bank of the checks in the cash letters in question under the terms of the collection contract raised an equitable charge or lien against the reserve deposit of said bank, and in holding, in consequence thereof, that the Reserve Bank had the right to apply the reserve deposit balance of the Lake City Bank toward payment of said checks; and the Court erred further in failing to hold that the failure and suspension of the Lake City Bank fixed the status of its reserve deposit as part of its general assets, and that no charges could thereafter be made by the Reserve Bank to deplete such reserve deposit for the purpose of paying the amounts of the checks in said cash letters, thereby giving the customers and depositors of the Reserve Bank a preferred status at the expense of the general creditors of the Lake City Bank.

V.

ARGUMENT.

Summary of Argument.

The petitioner contends:

A.

That there was neither agreement of the parties, nor understanding implied from the terms of collection, to

treat the reserve deposit balance either as equitably assigned or as a specified fund pledged to the payment of the accepted checks.

B.

That the exercise of the clearing-house functions of the Reserve Bank was not based upon the faith of the reserve deposit balance, and the authority of the Reserve Bank to make charges against the reserve deposit of the Lake City Bank was revoked by the insolvency of said bank.

C.

That the principles declared by this Court in Equitable Trust Co. *v.* First National Bank of Trinidad, 275 U. S. 359, should have been held by the Circuit Court to be controlling against the position of the Reserve Bank.

POINT A.

There was neither agreement of the Parties, nor understanding implied from the terms of collection, to treat the Reserve deposit balance either as equitably assigned or as a specified fund pledged to the payment of the accepted checks.

The acceptance of the checks by the Lake City Bank, as drawee, was not followed either by express assignment of any part of the reserve balance or by setting apart a specified sum to meet their payment. There were no unusual circumstances in the transaction. No

assurance was given that the particular fund in the reserve account should be the source from which payment would be made. The cash letters under which the checks were forwarded contained merely the notation, in substance, that at the expiration of three business days from the dates, respectively, of the cash letters, the checks therein transmitted would become *"chargeable against available balance in reserve account"* (R. p. 62-63). An assent to these terms carried with it neither tender of security nor any representation other than the understanding that the drawee bank (Lake City Bank), would, at its convenience within the agreed transit time, provide funds to make the payment at the Reserve Bank.

It is said, however, that the check collection circular, prescribing the terms of collection, establishes the right to make the charge as contended by the Reserve Bank. But this circular letter plainly states that the drawee bank has *"within the agreed transit time"* the right *"either* to remit * * * *or* to provide funds available to us (the Reserve Bank) to meet such cash letters." The full provision in this connection is as follows:

> "Checks received by us drawn on our member banks will be forwarded in cash letters direct to such banks and each member bank *will be required either to remit therefor in immediately available funds or to provide funds available to us to meet such cash letters within the agreed transit time to and from the member bank. Therefore, the amount of any cash let-*

> *ter to a member bank is chargeable against available funds in the reserve account of such member at the expiration of such transit time, which date will be shown on each cash letter.* * * *" (Italics inserted.) (R. 55.)

If there is room for doubt concerning the intent of the provision, the doubt must be resolved against the Reserve Bank as the party whose language it becomes necessary to construe. Moulor *v.* Insurance Co., 111 U. S. 335; American Surety Corporation *v.* Pauly, 170 U. S. 133. All that the parties agreed either expressly or by implication was that the obligations incurred by the Lake City Bank by the acceptance of the checks should be paid by specified dates, which dates were shown in the cash letters in which the checks were sent. See National City Bank *v.* Hotchkiss, 231 U. S. 50. It was left to the drawee bank to *provide funds* for payment of the accepted checks in the manner most convenient to itself, either by special remittance for the particular purpose, or by providing through general remittances for a sufficient balance in the reserve account, available at the expiration of the transit period to the Reserve Bank, to meet such cash letters. Either method served the same end—to pay a debt which by agreement of the parties was to be paid at Richmond on a fixed day.

In National City Bank *v.* Hotchkiss, *supra*, in disposing of the contention that the course of dealing between the parties was such as to create a trust relationship, the Court said:

> "All that the parties agreed either expressly or by implication was that the debt incurred at 10 o'clock should be paid at 3 * * *(p. 57). The consent to become a general creditor for an hour, that was imported, even if not intended to have that effect, by the liberty allowed to the firm, broke the continuity and established the loan as part of the assets" (p. 58).

In Commercial National Bank *v.* Armstrong, 148 U. S. 50, one bank transmitted to another bank commercial paper for collection under an agreement by the bank receiving the items to collect at par and remit at stated intervals. It was held that the relation of debtor and creditor was created. The reason of the decision was that collections made between the days of remitting are not, under the agreement and by the custom of banking, special deposits, but the moneys thus received pass into the general funds of the bank to be used by it as other funds; and when the day for remitting comes, the remittance is to be made out of such general funds.

A like situation exists here. The owners of the checks became general creditors of the Lake City Bank when their checks were accepted and cancelled. The terms upon which the checks were handled provided for a three day transit period. The checks sent from Richmond on the afternoon of the 7th were received in Lake City on the morning of the 8th. The Lake City Bank had, therefore, two days *after* its acceptance of the checks to provide funds to meet payment. *How the funds might be provided—whether from existing*

reserve balances, prospective reserve balances, shipments of currency, drafts upon other depositories, or otherwise—was not the concern of the owners of the checks, and no right was given them to demand that the reserve balances of the drawee bank should not be drawn upon for other purposes. On the contrary, it is to be noted that Section VI of Regulation J, Series of 1924, makes collection circulars binding upon the customer banks sending checks to the Reserve Bank for collection (R. 47), and said Circular No. 143 provides:

> "This circular sets forth fully the terms and conditions under which deposits of cash items will be accepted by the Federal Reserve Bank of Richmond * * * (R. 48).
>
> * * * * * * *
>
> "Conditions under which Items will be Received.
>
> "Every bank sending checks or other cash items to the Federal Reserve Bank of Richmond, or to another Federal reserve bank direct for our account, by such act will be understood to have agreed to the terms and conditions of this circular and of Regulation J of the Federal Reserve Board" (R. p. 49).

Hence it seems clear that the customers of the Reserve Bank sending checks to it for collection were charged with notice of the aforementioned provisions in said circular, permitting the drawee bank to pay for the checks other than by appropriation of its reserve

balance. They are also charged with notice of the following provisions of Section 19 of the Federal Reserve Act (12 U. S. C. A. 464) permitting the reserve accounts of member banks to be checked against or withdrawn:

> "*The required balance carried by a member bank with a Federal reserve bank may*, under the regulations and subject to such penalties as may be prescribed by the Federal Reserve Board, *be checked against and withdrawn* by such member bank for the purpose of meeting existing liabilities; provided, however, that no bank shall at any time make new loans or shall pay any dividends unless and until the total balance required by law is fully restored" (Section 19 of the Federal Reserve Act, 12 U. S. C. A. 464). (Italics inserted.)

It is also to be noted that the customer banks assume the risk of failure and suspension of the drawee bank and agree that in such event checks for which remittance is not made may be charged back to their accounts by the Reserve Bank, said Circular No. 143 providing in that respect: that the Reserve Bank acts only as collecting agent (R. 50); that the Reserve Bank may forward the checks "direct to the bank on which they are drawn" (R. 50); that the Reserve Bank shall not be held liable for any loss resulting from "the failure of the drawee bank or any agent to remit for such checks" (R. 50); and that

> "The amount of any check for which payment in actually and finally collected funds is not re-

ceived shall be charged back to the forwarding bank, regardless of whether or not the check itself can be returned" (R. 51).

As a matter of actual practice the reserve account, in the instant case, appears to have been treated at all times as subject to be checked against and withdrawn. The ledger entries, showing the conditions of the Lake City Bank's account from September 15, 1926 until the closing of the bank (R. pgs. 64-65), show a reserve balance of constantly fluctuating and uncertain nature, checked against or withdrawn at will,—and never treated as being charged with the payment of outstanding collection items until specifically appropriated to that end. The reserve balance at the close of business on October 7th, and at the opening of business on October 8th, when the cash letter of October 7th was accepted by the Lake City Bank, was $32,196, *but no attempt was made, either by the Reserve Bank or by the Lake City Bank to treat this balance as a fund charged with the payment of said cash letter,* and charges amounting in the aggregate to over $55,000 were made by the Reserve Bank on the 8th and 9th of October against said reserve deposit, and the balance of $22,085.52 ($22,088.48 was the amount for which suit was brought) appearing in the reserve account at the close of business on the 9th, the day the Lake City Bank suspended, was still lacking $12,982.85 of being enough to meet the two cash letters outstanding.

Such recognized right on the part of the Lake City Bank to deplete at will, its reserve deposit, without

regard to accepted cash letters, is clearly inconsistent with any theory of equitable charge or lien arising against said deposit to secure payment of said cash letters.

The case of Fourth Street Bank *v.* Yardley, 165 U. S. 634, is cited in the Circuit Court's opinion as authority for the position that there was an equitable charge against the reserve balance which arose from the acceptance of the checks; the statement of the rule that was given application in that case being quoted as follows:

> "* * * yet the authorities establish that if in the transaction connected with the delivery of the check *it was the understanding and agreement of the parties* that an advance about to be made should be a charge on and be satisfied out of a specified fund, a court of equity will lend its aid to carry such agreement into effect * * *." (Italics inserted.) (R. p. 75.)

It will be noted, however, from this quotation that even the equitable relief afforded by a court of equity in the Yardley case was dependent upon the understanding and agreement of the parties that an *advance* about to be made "*should be a charge on and be satisfied out of a specified fund.*" The error of the Circuit Court in assuming that the position taken by the Reserve Bank falls within the principle announced in the Yardley case clearly appears, we think, upon exami-

nation of the circumstances stated in the opinion in the Yardley case as follows:

> (Pg. 651): "Both were banking institutions—banks of deposit. * * * *They were not correspondents the one with the other, and there was no deposit account kept by the one with the other; indeed, so far as the usual course of commercial transactions was concerned, the banks were strangers.* The application, therefore, by the Keystone Bank to the Fourth Street Bank for accommodation under these circumstances precludes the conception that the relation between the parties was purely one of a usual and customary nature. * * *
>
> "The deduction arises that, as it cannot be reasonably conceived that the loan would have been made without the reference to and assignment of the particular fund from which alone the hope of immediate payment was to be reasonably expected, *the parties must have and did intend to create a particular appropriation, charge, or lien on the property upon the faith of which they both dealt.* The transaction, therefore, was a proposition to borrow on the one hand, accompanied with the disclosure that security was necessary and tendering the security, and, on the other hand, an acceptance of such proposal and an advance made on the faith of it. * * *
>
> (Pg. 652): "The Fourth Street Bank, as stated, was under no obligation to grant the request of the Keystone Bank; it was to derive no pecuniary advantage whatever from the proposed transaction; *it was not in any sense for the convenience of the Fourth Street Bank that the contract was made, and the bank clearly contemplated an immediate reimbursement, if it deliv-*

ered the (clearing house) certificates asked for. Had the transaction been an ordinary one, * * * and not, as it was, an extraordinary transaction, we might well presuppose that it was the expectation of the Fourth Street Bank that the borrower should merely have on hand with the Tradesmen's Bank when the check was presented a sufficient amount to pay it.

"*But the Keystone Bank, in disclosing its hazardous situation and indicating the specific fund dedicated to the payment of the solicited accommodation, did not represent that it expected to further check against the Tradesmen's Bank before the check which it proposed to give might be presented. The statements made clearly implied to the contrary,* exhibiting as they did the embarrassment of the borrowing bank, arising from the need of available cash to meet its clearings, and proposing a transaction by which the Fourth Street Bank would obtain from a bank, but a few hours distant, the prompt and certain payment of its advance.

"*As stated, this was manifestly not an ordinary mercantile transaction, but one of an extraordinary character,* and when we consider the situation and conduct of the parties, the disclosures made at the time of the contract, and weigh the probabilities of the case, *it is impossible to infer otherwise than that it was intended that the particular fund in the Tradesmen's Bank should be not only the source from which payment of the check to be given should be made, but that the fund should be transferred and appropriated pro tanto for that purpose.* * * *

(Pg. 653): "As the Fourth Street Bank contracted and parted with its money on the faith of

> the representation of the Keystone Bank that there was to its credit, in the Tradesmen's Bank, *a specific sum*, and the fund which came into the hands of its voluntary assignee is the fund as to which the representations were made, the Keystone Bank and its assignee are in equity estopped from asserting, to the prejudice of the Fourth Street Bank, that the character and condition of the fund was otherwise than it was represented to be'' (165 U. S. 651-653). (Italics inserted.)

The ordinary clearance transaction in the case at bar presents none of the elements appearing in the above stated facts in the Yardley case, wherein there was (1) a proposition to borrow; (2) a disclosure that security was necessary; (3) tendering the security; (4) the acceptance of such proposal and an advance made on the faith of it; and (5) the intention that the particular fund in the Tradesmen's Bank should be not only the source from which the payment of the check should be made, but that the funds should be transferred and appropriated *pro tanto* for that purpose.

In the case at bar the controlling elements of the transaction are altogether different, viz: (1) the recognized right of the Lake City Bank to use its reserve account for general purposes during the period between the acceptance of the collection items and the expiration of the transit time, which date was shown on each letter; and, (2) the right of the Lake City Bank *either* to remit, *or* to provide funds, at its convenience, subject only to the simple unsecured agree-

ment contained in Circular No. 143, "*to meet such cash letters within the agreed transit time to and from the member bank.*" Or, adapting to this transaction the terms used in the Yardley case, the course of dealing between the banks, instead of implying a representation that the Lake City Bank did *not* expect to further check against its deposit balance, made clearly to the contrary; and,—the transaction being an ordinary one —we might well presuppose that it was the expectation of the owners of the collected checks that the Lake City Bank should merely have on hand with the Reserve Bank, when the remittance became due, a sufficient amount to pay it.

Under such rights permitted to the Lake City Bank in respect to its reserve account, substantial balances may exist today; are gone tomorrow; are restored; the cash letters are paid; and the bank carries on. Or, on the other hand, the substantial balance which exists when the checks are dispatched for collection, and even when the checks are accepted, may be drawn out in a day's business; and, from the standpoint of security to the owner of the collection items, the intangible substance of the evanescent balance may have faded into nothingness when the bank fails.

The Principles Governing Equitable Assignments and Equitable Liens.

An agreement to remit for collection items, even where the remittance is to be made by a draft or a charge against a particular deposit account, does not constitute an assignment or create an equitable charge

against the deposit. **Christmas** *v.* **Russell**, 14 Wall. 69.

An agreement to pay out of a particular fund, however clear its terms, is not an equitable assignment, *if the assignor retains any control over the fund.* "The transfer must be of such a character that the fundholder can safely pay, and is compellable to do so. * * * Where the transfer is of the character described, *the fundholder is bound from the time of notice.*" Christmas *v.* Russel, 14 Wall. 69, 84; Meyer *v.* Delaware R. Constr. Co., 100 U. S. 457.

The duty of fundholders after notice is declared by Lord Ellenborough, in Williams *v.* Everett, 14 East, 582, cited in Tiernan *v.* Jackson, 5 Pet. 580, 600, that "they cannot retract the consent they may have once given; but are bound to hold it for the use of the appointee."

In **Smedley** *v.* **Speckman** (C. C. A. 3rd Circuit) 157 Fed. 815, 819, the absolute appropriation by the assignee of the funds sought to be assigned, and the surrender by the assignor of all control over the funds, are regarded as the requisites of a valid assignment. The opinion continues: "A mere promise, though of the clearest and most solemn kind, to pay a debt out of a particular fund, is not an assignment of the fund, even in equity. *To make an equitable assignment, there should be such an actual or constructive appropriation of the subject matter as to confer a complete and present right in the party meant to be provided for,* even where the circumstances do not admit of its immediate exercise. *If the holder of the fund retain*

control over it, it is fatal to the claim of the assignee." (Italics inserted.)

The principles governing the right of equitable lien likewise impose a duty on the part of the fundholder to devote the pledged fund to the purpose intended. A bank receiving deposits to apply for a particular purpose is bound, because of the trust, to apply such funds for the purpose specified, and for no other purpose. In stating and giving application to this rule, in the Interborough Consolidated Corporation case, 288 Fed. 334 (certiorari denied, Porges *v.* Sheffield, 262 U. S. 752), it is said:

> "*A particular fund is not 'charged' unless it is bound for the performance of an obligation imposed.*" (Italics inserted.) (Pg. 349.)

The application of the same principle is found in Woodhouse *v.* Crandall, 197 Ill. 104, 109, where it is said:

> "The banking firm assumed the position of a trustee and the money deposited constituted a trust fund, which *the bank was bound to keep intact for the purpose of the trust.*"

In Pomeroy's Equity Jurisprudence (4th ed.) section 1255, a statement of the conditions under which equitable liens or charges may be created is made as follows:

> "In order, however, that a lien may arise in pursuance of this doctrine, the agreement must deal with some particular property, either by identifying it, or by so describing it that it can

> be identified, *and must indicate with sufficient clearness and intent that the property so described, or rendered capable of identification, is to be held, given or transferred as security for the obligation.*"

So, in the case of United States *v.* Butterworth-Judson Corp., 267 U. S. 387, an equitable charge was held to be established by the deposit of money "in *special* accounts in banks, *separate* from its other funds," to be drawn upon only for specific purposes. The basis of decision is stated in the opinion of Mr. Justice Butler as follows:

> (Pg. 393): "*The agreements made the balances in the special accounts security for the obligations* of the contractor, and so created an equitable lien. (Pg. 394): * * * The purpose and effect of the special accounts was * * * *to limit the use of the fund to the purposes specified,* and so to make it available as security." (Italics inserted.)

Comments Upon Certain Cases Cited by the Court Below.

Certain cases are cited by the Circuit Court of Appeals in its opinion in support of its position (R. p. 76) and require some discussion at this point:

> *Federal Reserve Bank of Minneapolis vs. First National Bank of Eureka, 277 Fed. 300:*

In this case the Reserve Bank sued the Receiver of the insolvent bank to establish claims based upon (a)

the endorsement liability of the insolvent bank upon certain notes rediscounted with the Reserve Bank; (b) the amount of certain checks transmitted by the Reserve Bank to the insolvent bank in a cash letter for collection, which the insolvent bank had collected, and for which it had issued, in remittance, its draft to the Reserve Bank drawn upon a correspondent bank, said draft, however, not being paid before suspension of the insolvent bank. The Reserve Bank sought to apply toward payment of these obligations the deposit balance of the insolvent bank, and also the surrender value of the shares of stock owned by the insolvent bank in the Reserve Bank. The Federal District Court held that both the deposit balance, and the surrender value of the stock, should be applied toward payment of the entire indebtedness, including the amounts due under the cash letter represented by the remittance draft.

The case is, upon the surface, similar to the instant case, but there are distinguishing elements which make it clearly inapplicable as authority in support of the decision of the Court below. In the Minneapolis case immediate credit was given by the Reserve Bank to its customers who had forwarded the checks for collection, *and the Court held that the amount of said cash letter constituted a claim in favor of the Reserve Bank in its own right*, basing this in part upon a former regulation of the Reserve Board that member banks would be required to provide funds at par to cover all

checks received from Reserve Banks, and also upon the ground that the right of charge back could not be exercised by the Reserve Bank except in cases where the checks forwarded to the drawee bank were returned to the Reserve Bank, and that as to checks not so returned, and therefore not subject to charge back, the Reserve Bank was liable to its customers. In the instant case credit was *not* given to the Reserve Bank (R. p. 16); the drawee bank was *not* required, under Circular No. 143, to *keep* funds in its reserve account to meet cash letters, but had the option of *otherwise providing funds at the expiration of the transit period*, and finally the Reserve Bank has an absolute right in the instant case, to charge back the items regardless of the failure of the Lake City Bank and regardless of the return of the items to the Reserve Bank (Circular No. 143, numbered paragraphs 3, 4 and 6, pages 50 and 51 of Record). It is also to be noted that the Court below specifically held that the liability of the insolvent bank in the instant case is not due to the Reserve Bank, inasmuch as the Reserve Bank is only an agent for collection, but is due to the customers of the Reserve Bank, and that consequently there is no right of set off in favor of the Reserve Bank (R. pgs. 76-77), whereas in the Minneapolis case the Court held the insolvent bank to be indebted to the Reserve Bank and that consequently the right of set-off did exist.

Keyes, Receiver of First National Bank of Clarkfield, vs. Federal Reserve Bank of Minneapolis (an unreported decision of the United States District Court, District of Minneapolis, and to be printed by respondent as an appendix to his brief):

In this case the Reserve Bank had transmitted, as collection agent, items to the Clarkfield Bank, and before remittance had been made the Clarkfield Bank suspended. The Court stated that the sole question for decision was whether or not the Reserve Bank had the right to set off the deposit balance of the insolvent bank against the amount of the unpaid items collected by the Clarkfield Bank, and held that such right of set off did exist and that the Reserve Bank had a right of action against the insolvent bank "*in its own name and in its own right.*" The checks are treated in the opinion as having been endorsed without restriction and with credit on that day given to the bank depositing the same. The further comment is made by the Court: "The plaintiff has no standing to inquire into the relations between the defendant and its depositing banks. Neither the insolvent nor its Receiver has any concern with the question of ownership of the checks."

It being clear in the instant case that the Reserve Bank did not have a right of action in its own name, and did not have a right of set off, it would seem that the Keyes case has no application, for the reasons hereinbefore stated.

Storing vs. First National Bank, 28 Fed. (2) 587:

It seems to have been assumed (without any particular consideration of the point) that the items in question were owned by the forwarding bank in its own right, and that, as soon as the collections were made, the collecting bank became the debtor of the bank transmitting the items for collection. Upon the basis of this assumption the right of offset was held to exist. The premise governs the conclusion; and manifestly the conclusion has no application in the present case where the premise is the exact opposite.

Midland National Bank & Trust Company vs. First State Bank of Sioux Falls, 222 N. W. ~~217~~ 274, 275:

The position was taken that the forwarding bank "had the legal title, so to speak, to the dishonored drafts." The same criticism as that made of the Storing case applies. The decision in the Midland case seems also to be substantially influenced, if not wholly controlled, by the viewpoint that the claim involved only the amount by which the assets of the insolvent bank "were enhanced through the collections made immediately prior to its suspension." This also presents an obvious point of difference from the present case, where the checks were all drawn on the insolvent bank and were collected by charging them to the accounts of depositors of that bank, resulting only in a shifting of credits rather than in an augmentation of

assets. Larabee Mills *v.* First Nat'l Bank, 13 Fed. (2) 330; American Can Co. *v.* Williams, 178 Fed. 420.

POINT B.

The exercise of the Clearing-house functions of the Reserve Bank was not based on the faith of the Reserve Balance of the Member Bank.

The Federal Reserve Act originated in the need of stabilizing financial conditions. The requirement of reserve balances was designed *primarily* to provide available funds for the Federal reserve banks to take care of the financial needs of their member banks; the existence of which depended on the resources available to them and on the protection afforded to their depositors. To give this protection was the main—because the most vital—object of the banking provisions. Reserves were necessary to safe banking. *Each member bank was required to contribute its proportionate part to the strength of the financial system.*

Under the terms of Section 16 of the Federal Reserve Act the exercise of clearing house functions was permissive but not mandatory (12 U. S. C. A. 248 (*m*)). This was seemingly considered a minor part of the reserve system activities. There is no indication from any of the provisions of the Act that clearing house functions of the system were even remotely in mind so far as the statutory provision for reserve balances was concerned.

The discussion under the preceding point has indicated, with reference to the nature of the reserve de-

posit: That the deposit may be checked against and completely withdrawn, and that the amount of available balance at the expiration of the transit period is necessarily dependent upon the extent of withdrawals and deposits *after* the acceptance by the drawee bank of the checks; that the deposit is not a special account, and that no funds are set apart, to be kept separate from other funds, for the purpose of providing security for the handling of collection items; that the balance in the deposit is not required to be maintained at an amount sufficient to cover outstanding cash letters; that neither the amount of the reserve deposit, nor the probable extent of withdrawals, nor the particulars of the balance at any given time, are known to the customers of the reserve bank forwarding items to the reserve bank for collection; that the checks may be sent direct to the drawee bank, and that the only obligation of the drawee bank is to provide funds at the expiration of the transit time; that the customers of the reserve bank forwarding items for collection assume the risk of failure of the drawee bank, and that items for which remittance of payment have not been made by the drawee bank may be charged back to the account of said customers.

In view of the foregoing it seems clear that the customers of the Reserve Bank do not send items to the reserve bank on the faith of the reserve balance of the drawee bank and that they rely entirely upon the unsecured obligation of the drawee bank to provide available funds at the expiration of the transit period.

Set-off.

It is not understood that the Reserve Bank now contends that a right to apply the deposit account toward payment of these cash letters by way of set off exists, but in the interest of completeness of discussion, the point is here mentioned.

The Court below considered the point in connection with the second cause of action when it denied the right of the Reserve Bank to set off the amount due from the Reserve Bank to the Lake City Bank for the cash surrender value of the reserve stock against the liability of the Lake City Bank for the amounts of the cash letters. The Circuit Court of Appeals said in that connection:

> "It is perfectly clear that the liability of the insolvent member bank for these checks is a liability owing to the owners of the checks in which the Reserve Bank is not interested except as collection agent, and is not 'a debt of the insolvent member bank to the Federal Reserve Bank' within the meaning of the statute.
>
> "Even in the absence of a statutory direction as to how the liability should be applied, a set off of checks held for collection against such a liability would not be allowed, for the reason that demands to be set off against each other must be mutual, that is they must be due to and from the same parties and in the same capacity. 14 R. C. L. 656; 24 R. C. L. 858; Morse on Banks and Banking (6th Ed.) 334; Bank of the Metropolis *v.* New England Bank, 6 Howard 212; Smith *v.* Bath L. & B. Ass'n — Me. —, 136 Atl. 284, 50

A. L. R. 526; Yardley *v.* Clothier, 51 Fed. 506" (R. pgs. 76-77).

Also see National Bank *v.* Insurance Co., 104 U. S. 54, 71; Scott *v.* Armstrong, 146 U. S. 499.

The foregoing applies with equal force to the amount owing by the Reserve Bank to the Lake City Bank on the reserve deposit, and the Reserve Bank therefore had no greater right to set off the amount it owed the Lake City Bank for the deposit than it had to set off the amount it owed for the surrender value of the stock.

The authority of the Reserve Bank to withdraw funds from the Reserve account of its member bank was revoked by the insolvency of the member bank.

Assuming that the foregoing discussion has established that an equitable lien or charge did not exist against the deposit account of the Lake City Bank in favor of the customers of the Reserve Bank, and that consequently the Reserve Bank could not, on that ground, charge the account of the Lake City Bank with the amounts of said cash letters, and assuming, further, that no right of set off existed, it follows that if the Reserve Bank had the right otherwise to charge said account, such right must be based upon an *unrevoked authority* from the Lake City Bank to the Reserve Bank to charge said account.

It is not denied, by the petitioner, that by accepting the provisions of Circular No. 143, the Lake City Bank did invest the Reserve Bank with authority to charge

its account for the payment of outstanding cash letters, such authority to be exercised, normally, at the expiration of the current transit period but also to be exercisable, at the option of the Reserve Bank, "at any time when in any particular case we (Reserve Bank) deem it necessary to do so" (R. p. 55).

It is conceded by the Reserve Bank, however, that nothing had been done toward the exercise of the authority to charge the reserve account until after it had received notice of the failure and suspension of the Lake City Bank (R. pgs. 18-19-20). Consequently, it is the position of the petitioner that the insolvency and suspension of the Lake City Bank prior to the exercise of such authority, revoked the authority, and that the Reserve Bank could not thereafter charge such account.

The general rule is thoroughly well settled that upon insolvency or bankruptcy the assets of a debtor whereever situated, belong to his creditors, and that all third persons hold said assets in trust for the creditors and have no authority to dispose of the same. A familiar illustration, which applies by analogy to the instant case, arises where a debtor issues a check before insolvency. The bank upon which the check is drawn is, by the operation of the foregoing principle, forbidden to cash the check after the insolvency has been, by appropriate action, formally established. The reason is, of course, that the insolvency or bankruptcy of the debtor revokes any authority theretofore given by the debtor to disburse or diminish his assets, and the check

is merely an order or authority issued by the debtor on his banker authorizing and directing the banker to disburse part of his funds to the holder of the check. A banking case having very close analogy to the instant case, in principle, is First National Bank of Chicago *v.* Selden, 120 Fed. 212. In that case the receiver of a national bank brought suit against another national bank to recover the amount of certain cashier's checks issued by the insolvent bank prior to suspension and paid by the drawee bank after notice of suspension. The Circuit Court of Appeals, in sustaining the right of the receiver to recover, said in part as follows:

> (Pg. 214): "In Bank *v.* Schuler, 120 U. S. 511, 7 Sup. Ct. 644, 30 L. Ed. 704, it was decided, that as between the right of general creditors in a fund received from a bank by an assignee under a general assignment for the benefit of creditors, and the payee of an outstanding check or draft, there was no such equitable assignment *pro tanto*, of the funds in the drawee's possession, as gave to such payee a priority over the general creditors. *This, unquestionably, is the law, also respecting funds in the hands of a receiver of a national bank, appointed by the Comptroller. In each case the purpose is to obtain a ratable distribution of the insolvent bank's assets.* In neither case, in the absence of an assignment more effective than the drawing of a check, will the federal law allow one set of creditors to obtain an advantage over another set." (Italics inserted.)

In Scott *v.* Armstrong, 146 U. S. 499, 507, this Court said:

> "The Fidelity National Bank was closed by order of the bank examiner June 20th, the Receiver was appointed June 27th * * * title to its assets was necessarily thereby transferred to the Receiver. National Bank *v.* Colby, 21 Wall. 609, * * *."

Also see Edison Electric Illuminating Company *vs.* Tibbetts, 241 Fed. 468.

The provision in Circular No. 143 giving the Reserve Bank the right to charge the Lake City Bank's reserve account "at any time when in any particular case we deem it necessary to do so", is on exactly the same fundamental basis as the authority to charge at the expiration of the transit period, the only difference being as to the point in time when such authority might have been executed. The Reserve Bank *could* have exercised the authority to charge at any time during the transit period *prior to suspension* of the Lake City Bank but, such authority *not* having been exercised prior to suspension, its revocation occurred just as surely, by suspension of the Lake City Bank, as the revocation of the authority to charge at the expiration of the transit period.

The position here taken is not at variance with the principles established in McDonald *v.* Chemical National Bank, 174 U. S. 610, referred to by the Court below in its opinion (R. pgs. 73-74). In the McDonald case the insolvent bank, prior to suspension, was indebted to the Chemical Bank by reason of the overdraft

of its account with the Chemical Bank. To meet that overdraft the Capital Bank sent the Chemical bank by mail, prior to suspension, certain items for collection and for credit upon the overdraft. The items were received subsequent to suspension. The Supreme Court held that the items *were the property of the Chemical Bank* when placed in the mails. It will be noted in this connection that the Chemical Bank was a creditor of the Capital Bank *in its own right,* and that the Capital Bank had, prior to suspension, actually transmitted the item for the purpose of passing title to the Chemical Bank in part payment of that indebtedness. The Court held that in point of time the delivery of the items to the United States mail was a delivery of title to the Chemical Bank and hence that delivery occurred prior to suspension and consequently was not affected by suspension. There would seem to be no analogy between that case and the instant case. The Reserve Bank was not a creditor of the Lake City Bank and the Lake City Bank had not, prior to suspension, remitted any monies or items to the Reserve Bank, except for deposit in its reserve account in usual course, nor had the Reserve Bank, prior to suspension, exercised its right to charge the reserve account of the Lake City Bank.

The Reserve Bank seems to consider that the theory of revocation of authority to charge the deposit account depends for its application upon the existence of an agency between the Lake City Bank and the Reserve Bank, and that inasmuch as the Reserve Bank was agent of its customers for the purpose of collec-

tion of the checks contained in the cash letters, and was not an agent of the Lake City Bank, the revocation theory must fail. Petitioner concurs with the Reserve Bank in the position that the Reserve Bank was not an agent of the Lake City Bank and that it was an agent of its customers for the collection of its checks. It is not essential, however, to the revocation theory that agency exist between the Reserve Bank and the Lake City Bank, any more than it can be said that every time one draws a check upon his bank he constitutes the bank his agent. The relation between a depositor and his bank is that of debtor and creditor, and the check or other order upon the bank issued by the depositor is not that of a principal to his agent, but that of a creditor authorizing and directing his debtor how, and to whom, a portion of his credit at the bank may be disbursed. Hence the lack of agency between the Lake City Bank and the Reserve Bank does not prevent the application of the revocation of authority doctrine.

Point C.

The decision of this Court in Equitable Trust Co. v. First National Bank of Trinidad, 275 U. S. 359, is authority against the position of the Reserve Bank.

The firm of Knauth, Nachod & Kuhne, hereafter called the bankrupts, were international bankers. They had credit with many foreign banks; and, to enable small banks in this country to issue drafts upon such foreign banks in their own name, offered these

terms: "Upon receipt of advice of draft, accompanied by adequate funds payable at par in New York, we shall promptly forward our advice of the same and provide the drawee with funds sufficient for the payment of the draft abroad, *by a transfer of credit from our balance, or otherwise,* provided the draft is drawn on the bank named in our latest list of correspondents" (Pg. 365). In accordance with this plan, the Trinidad Bank drew a draft on a branch of the Banca Commerciale Italiana, advised the bankrupts that they had drawn the draft, and remitted funds to the bankrupts which they received and deposited to their general account. The bankrupts sent to the Italian bank a list and description of drafts issued, including the draft issued by the Trinidad bank, with a request to "honor the above listed drafts charging same to our account." (Pg. 366.) The Italian bank debited the account of the bankrupts and made a corresponding credit at the same time in an account termed "drafts payable." The draft of the Trinidad bank *was presented after the petition in bankruptcy had been filed,* and was dishonored.

The Circuit Court of Appeals, Second Circuit, 13 Fed. (2d) 732, 735, held that an equitable charge had been created by the agreement and acts of the parties, saying:

> "Therefore it seems to us that the agreement to transfer the credit, *followed by its actual transfer,* provided a fund which the drawee was obliged to devote to the payment of the draft; that is, that it created an equitable assignment

> or an irrevocable declaration of trust by the bankrupts" (pg. 735).

A writ of certiorari was applied for and was granted by this Court. Upon the hearing of the cause, the court divided. The majority opinion, written by Mr. Justice Holmes, stated the conclusion that the transaction did not constitute the appropriation of funds for a specific use and did not show an intent to establish

> "an attenuated property right in an account to which no special funds were attached and the particulars of which neither the respondent nor the purchaser of the check could know." (Pg. 369)

The analysis of the case made by Mr. Justice Holmes shows a consideration of factors leading to this conclusion as follows: (1) the ignorance of the whole affair on the part of the holder; (2) the general understanding that the account was subject to the bankrupt's control; and (3) that

> "the terms offered by the bankrupts to their correspondents seem to us to promise the appropriation of a specified fund to the draft as little as they promise to apply the money received by them to that end. They are to provide the drawee bank with sufficient funds for the payment of the drafts by transfer of credit 'from our balance *or otherwise'. They are to provide, that is, as convenient to themselves, for payment by the drawee bank; *not to give them an earmarked corpus to be handed over.*" (Pg. 367)

In the banking transaction above reviewed, we find: (1) the agreement of the insolvent bank to provide

sufficient funds to meet payment of the items; (2) the authority to the bank in which the funds of the insolvent bank were held on general deposit, to make an appropriation of such funds for the purpose of payment; and (3) the setting apart of funds,—under such authority and in accordance with the standing agreement between the insolvent bank and the bank in which the deposit account was carried,—to a special "drafts payable" account for the purpose of meeting the items in transit.

In the case at bar,—under the provisions of Regulation J and the check collection circular issued pursuant thereto,—we find only the agreement of the insolvent bank *to provide funds,* and the authority to the Reserve Bank, in which funds of the insolvent bank were held on general deposit, to make an appropriation of available funds in the deposit account for the purpose of the payment. The sole requirement of the insolvent bank in the instant case was to provide sufficient funds to meet the payment of the checks at a later specified date, by transfer of credit from available funds in the reserve account 'or otherwise'. Its obligation was to provide these funds *in such manner as might be convenient to itself* within the three day transit period and not to furnish upon the acceptance of the check either "an earmarked corpus to be handed over" or "an attenuated property right in an account to which no special funds were attached."

In the Bank of Trinidad case the money was directly deposited with the bankrupt upon the agreement that it should be paid over to the owner through the clear-

ing bank by establishing a credit which would be subject to the drafts of the owners of the money. In the case at bar, the owners of checks drawn on the Lake City Bank deposited the checks with the Reserve bank for collection upon the agreement that, at the expiration of the transit period, and upon the proceeds of the *collections being received*, the credit thereby established at the Reserve bank would be subject to the drafts of the owners of the money.

The theory of a distinction between the two cases, as held by the Circuit Court of Appeals, seems somewhat difficult to follow in considering the application of the principles involved in the Bank of Trinidad opinion.

The division of opinion in the Bank of Trinidad case arose because of circumstances which were believed in the minority opinion to show the complete performance of the bankrupt's agreement to provide funds, by setting apart in a special "drafts payable" account enough of its credit with the clearing bank to meet the payment of the items in transit. This feature of the Bank of Trinidad case, which was the basis of decision in the Circuit Court and also the basis of the minority opinion in this Court, is altogether lacking in the case now presented; and the agreement to provide funds stands by itself without anything having been done to carry the agreement into effect until after the act of insolvency had occurred.

The soundness of decision in the case of Eastman Kodak Co. *v.* National Park Bank, 231 Fed. 320, affirmed 247 Fed. 1002, is recognized in the majority

opinion of this Court in the Bank of Trinidad case. It had likewise been recognized, although refused application, in the Circuit Court opinion, 13 F. (2d) 732, 735, where the Court commented on the Eastman Kodak Co. case that "the drawee had not transferred the credits, and, so far as appeared, remained free to pay the drafts in the order of their presentation." The opinion then continued:

> "Mere notice by the drawer does not establish a priority upon the fund in favor of the drafts advised. It is a vital difference when the drawee by specific credits provides for specific drafts. These must then be paid, no matter how many others come in before them, and that implies a final appropriation *pro tanto.*"

Were specific credits provided to meet the specific payments? This was the question of the Bank of Trinidad case, and the majority opinion held that the specific credits had not been provided. This is also the question of the case at bar. The Circuit Court opinion in the instant case has answered the question by saying that "the rights of the owners of the checks to have same charged against the reserve account of the drawee bank arose and became fixed when the bank accepted them" (R. pg. 74). But if this was the result of the acceptance of the checks, there must also have been the corollary result that these charges "must then be paid, no matter how many others come in before them and that implies a final appropriation *pro tanto.*" (13 Fed. (2) 735.) The facts of the transaction deny the theory of the opinion. The cash letter for $14,-

900.62, forwarded on October 7, was accepted by the Lake City Bank on October 8. The reserve balance on the morning of that day was $32,196. This was used to pay other liabilities of the Lake City Bank, the charges against the deposit account of the 8th being $33,565. The balance was partly restored during the day by deposits amounting to $28,150. The cash letter of the 8th for $20,170.71 was accepted by the Lake City Bank on October 9. The balance on the morning of the 9th was $26,781; charges $21,848; credits $17,153. The funds remaining in the reserve balance at the close of business on the 9th were of the same general character as the funds that had been freely paid out of the reserve account on the 8th and 9th, after checks contained in the cash letters had been accepted.

It was contemplated that *available* funds existing in the reserve account on the morning of the 11th should be applied, if settlement had not otherwise been made, to the payment of the cash letter of the 7th; and likewise, *available* funds on the 12th to the payment of the cash letter of the 8th. It was equally within the contemplation of all the parties to the transactions that the reserve balances of the 8th and 9th—as they existed when the cash letters were accepted—could be drawn upon and paid out for other purposes. *The funds in the reserve balance, which were thus treated as general assets of the bank up to the time it closed, must still be treated as general assets;* and, as such, *not* available to apply to the payment of the outstanding cash letters.

Conclusion.

(1) *The Equities Lie with the Receiver.*

The Receiver represents the general creditors of the insolvent bank. Section 5234, U. S. R. S. (12 U. S. C. A. 192), ~~provides~~ contemplates that the administration of the assets shall be by the Receiver for the benefit of the general creditors, and Section 5236, U. S. R. S. (12 U. S. C. A. 194), provides that from time to time a "ratable dividend" shall be made to such general creditors. First National Bank of Chicago *vs.* Selden, 120 Fed. 212; Scott *vs.* Armstrong, 146 U. S. 499, 506.

The funds in suit are assets of the insolvent bank. The distribution of such assets by the Reserve Bank, by appropriating them to the payment of the depositors of the Reserve Bank, instead of permitting them to be distributed by the Receiver for the benefit of all of the creditors, would be contrary to the statute, and would give such depositors of the Reserve Bank an unauthorized preference. Such depositors are creditors, not of the Reserve Bank, but of the insolvent bank, and should make their application to, and obtain their redress from, the Receiver.

(2) *The Deposit Should be Ordered Returned to the Receiver for the Benefit of the General Creditors.*

No right to an equitable charge, or to a set off, against the deposit, having been established, and the

authority of the Reserve Bank to charge the account having been revoked by notice of suspension, the deposit constitutes assets of the Receiver and should be ordered returned to him for the benefit of the general creditors including as such the owners of the items contained in the cash letters.

Respectfully submitted,

R. E. WHITING,
Counsel for Petitioner.

F. G. AWALT,
GEORGE P. BARSE,
Attorneys for Comptroller of Currency,
Of Counsel.

APPENDIX A.

Provisions of Federal Reserve Act.

(1)

The Federal Reserve Board shall make and promulgate from time to time regulations governing the transfer of funds and charges therefor among Federal reserve banks and their branches, and may at its discretion exercise the functions of a clearing house for such Federal reserve banks to exercise such functions, and may also require each such bank to exercise the functions of a clearing house for its member banks (Section 16 of the Federal Reserve Act, 12 U. S. C. A. 248 (*m*)).

(2)

The required balance carried by a member bank with a Federal reserve bank may, under the regulations and subject to such penalties as may be prescribed by the Federal Reserve Board, be checked against and withdrawn by such member bank for the purpose of meeting existing liabilities; provided, however, that no bank shall at any time make new loans or shall pay any dividends unless and until the total balance required by law is fully restored (Section 19 of the Federal Reserve Act, 12 U. S. C. A. 464).

APPENDIX B.

Regulation J, Series of 1924.

(Superseding Regulation J of 1920.)

Check Clearing and Collection.

SECTION I. Statutory Provisions.

Section 16 of the Federal Reserve Act authorizes the Federal Reserve Board to require each Federal reserve bank to exercise the function of a clearing house for its member banks, and section 13 of the Federal Reserve Act, as amended by the act approved June 21, 1917, authorizes each Federal reserve bank to receive from any nonmember bank or trust company, solely for the purpose of exchange or of collection, deposits of current funds in lawful money, national bank notes, Federal reserve notes, checks and drafts payable upon presentation, or maturing notes and bills, provided such nonmember bank or trust company maintains with its Federal reserve bank a balance sufficient to offset the items in transit held for its account by the Federal reserve bank.

SECTION II. General Requirements.

In pursuance of the authority vested in it under these provisions of law, the Federal Reserve Board, desiring to afford both to the public and to the various banks of the country *a direct, expeditious, and economical system of check collection and settlement of balances,* has arranged to have each Federal reserve bank exercise the functions of a clearing house and collect checks for such of its member banks as desire

to avail themselves of its privileges and for such nonmember State banks and trust companies as may maintain with the Federal reserve bank balances sufficient to qualify them under the provisions of section 13 to *send* items to Federal reserve banks for purposes of exchange or collection. Such nonmember State banks and trust companies will hereinafter be referred to as nonmember clearing banks.

Each Federal reserve bank shall exercise the functions of a clearing house and collect checks under the general terms and conditions hereinafter set forth.

SECTION III. Checks Received for Collection.

(1) Each Federal reserve bank will receive at par from its member banks and from nonmember clearing banks in its district, checks drawn on all member and nonmember clearing banks, and checks drawn on all other nonmember banks which are collectible at par in funds acceptable to the Federal reserve bank of the district in which such nonmember banks are located.

(2) Each Federal reserve bank will receive at par from other Federal reserve banks, and from all member and nonmember clearing banks in other Federal reserve districts which are authorized to route direct for the credit of their respective Federal reserve banks, checks drawn on all member and nonmember clearing banks of its district, and checks drawn on all other nonmember banks of its district which are collectible at par in funds acceptable to the collecting Federal reserve bank.

(3) No Federal reserve bank shall receive on deposit or for collection any check drawn on any nonmember bank which can not be collected at par in funds acceptable to the Federal reserve bank of the district in which such nonmember bank is located.

SECTION IV. Time Schedule and Availability of Credits.

(1) Each Federal reserve bank will publish a time schedule showing the time at which any item sent to it will be counted as reserve and become available for withdrawal or other use by the sending bank. For all checks received, the sending bank will be given immediate credit, or deferred credit, in accordance with such time schedule, and as provided below.

(2) For all such checks as are received for immediate credit in accordance with such time schedule, immediate credit, subject to final payment, will be given upon the books of the Federal reserve bank at full face value in the reserve account or clearing account upon day of receipt, and the proceeds will at once be counted as reserve and become available for withdrawal or other use by the sending bank.

(3) For all such checks as are received for deferred credit in accordance with such time schedule, *deferred credit, subject to final payment,* will be entered upon the books of the Federal reserve bank at full face value, but the proceeds will not be counted as reserve nor become available for withdrawal or other use by the sending bank *until such time as may be specified in such time schedule,* at which time credit will be transferred from the deferred account to the reserve account or clearing account subject to final payment and will then be counted as reserve and become available for withdrawal or other use by the sending bank.

SECTION V. Terms of Collection.

The Federal Reserve Board hereby authorizes the Federal reserve banks to handle such checks subject

to the following terms and conditions; and each member and nonmember clearing bank which *sends* checks to any Federal reserve bank for deposit or collection shall by such action be deemed (*a*) to authorize the Federal reserve banks to handle such checks subject to the following terms and conditions, (*b*) to warrant its own authority to give the Federal reserve banks such authority, and (*c*) to agree to indemnify any Federal reserve bank for any loss resulting from the failure of such sending bank to have such authority.

(1) A Federal reserve bank *will act only as agent* of the bank from which it receives such checks *and will assume no liability except for its own negligence* and its guaranty of prior indorsements.

(2) A Federal reserve bank may present such checks for payment or *send such checks for collection direct to the bank on which they are drawn* or at which they are payable, or in its discretion may forward them to another agent with authority to present them for payment or send them for collection direct to the bank on which they are drawn or at which they are payable.

(3) A Federal reserve bank may in its discretion and at its option, either directly or through an agent, *accept either cash or bank drafts in payment of or in remittance for such checks and shall not be held liable* for any loss resulting from the acceptance of bank drafts in lieu of cash, nor *for the failure of the drawee bank or any agent to remit for such checks,* nor for the nonpayment of any bank draft accepted in payment or as a remittance from the drawee bank or any agent.

(4) Checks received by a Federal reserve bank on its member or nonmember clearing banks will ordinarily be forwarded or presented direct to such banks, and such banks will be required *to remit or pay there-*

for at par in cash or bank draft acceptable to the collecting Federal reserve bank, *or* at the option of such Federal reserve bank *to authorize such Federal reserve bank to charge their reserve accounts or clearing accounts;* provided, however, that any Federal reserve bank may reserve the right in its check collection circular to charge such items to the reserve account or clearing account of any such bank at any time when in any particular case the Federal reserve bank deems it necesary to do so.

(5) Checks received by a Federal reserve bank payable in other districts will be forwarded for collection upon the terms and conditions herein provided to the Federal reserve bank of the district in which such checks are payable.

(6) The amount of any check for which payment in actually and finally collected funds is not received *shall be charged back to the forwarding bank,* regardless of whether or not the check itself can be returned.

SECTION VI. Other Rules and Regulations.

Each Federal reserve bank shall also promulgate rules and regulations not inconsistent with the terms of the law or of this regulation, governing the details of its check clearing and collection operations. Such rules and regulations shall be set forth by the Federal reserve banks in their letters of instruction to their member or nonmember clearing banks and shall be binding upon any member or nonmember clearing bank which *sends* any check to such Federal reserve bank for collection or to any other Federal reserve bank for the account of such Federal reserve bank for collection.